IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE

In re

Case No. 02-31000

COY LEE McCARTER
SUSAN RYMER McCARTER

Debtors

MEMORANDUM ON DEBTORS' MOTION FOR SANCTIONS

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RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

Before the court is the Motion for Sanctions Under Rule 9011 of the Federal Rules of Bankruptcy Procedure (Motion for Sanctions) filed by the Debtors on October 20, 2003, seeking the imposition of sanctions against Joe F. Justice, III (Mr. Justice) based upon the proof of claim filed by Mr. Justice on March 6, 2003. The Debtors aver that Mr. Justice filed his proof of claim for an improper purpose, while knowing that there was no basis for the claim that could be supported by evidence. In opposition to the Motion for Sanctions, Mr. Justice filed the Motion by Pro Se Creditor Joe F. Justice III to Deny Sanctions Under Rule 9011 of the Federal Rules of Bankruptcy Procedure (Response) on November 18, 2003. A preliminary hearing on the Motion for Sanctions was held on December 11, 2003, at which time the court, at the Debtors' request, fixed a March 1, 2004 trial date.[1] For reasons hereinafter stated, the court has determined that the Motion for Sanctions can be disposed of as a matter of law and that an evidentiary hearing is therefore unnecessary.

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(A), (O) (West 1993).

I

The Debtors filed the Voluntary Petition commencing their bankruptcy case under Chapter 11 of the Bankruptcy Code on February 26, 2002. On March 6, 2003, Mr. Justice filed a proof of claim in the amount of $160,000.00 for "wages, salaries and compensation . . . for [u]npaid

[1] When a trial date was requested, the court advised the Debtors and Mr. Justice that the Motion for Sanctions might well be disposed of without the necessity of a trial.

compensation for services performed from 11/99 to 12/01." The Debtors filed an objection to Mr. Justice's claim on June 5, 2003, and the trial on the objection was held on October 20 and 24, 2003. On November 25, 2003, the court filed an Order and Memorandum on the Debtors' Objection to Claim of Joe F. Justice, III, sustaining the objection and disallowing Mr. Justice's claim. Mr. Justice did not appeal the Order.

The Debtors' Motion for Sanctions was filed on October 20, 2003, prior to the trial and subsequent ruling on the Debtors' objection. Accordingly, the court entered an Order on October 29, 2003, directing Mr. Justice to file a response and setting the hearing on the Motion for Sanctions for December 11, 2003. Mr. Justice filed his Response in compliance with the court's October 29, 2003 Order.

II

Federal Rule of Bankruptcy Procedure 9011 governs representations to the court and states, in material part:

> (a) Signing of papers
>
> Every petition, pleading, written motion, and other paper, except a list, schedule, or statement, or amendments thereto, shall be signed by at least one attorney of record in the attorney's individual name. A party who is not represented by an attorney shall sign all papers. Each paper shall state the signer's address and telephone number, if any. An unsigned paper shall be stricken unless omission of the signature is corrected promptly after being called to the attention of the attorney or party.

(b) Representations to the court

By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,—

(1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;

(2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;

(3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and

(4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

(c) Sanctions

If, after notice and a reasonable opportunity to respond, the court determines that subdivision (b) has been violated, the court may, subject to the conditions stated below, impose an appropriate sanction upon the attorneys, law firms, or parties that have violated subdivision (b) or are responsible for the violation.

FED. R. BANKR. P. 9011 (footnote omitted). Bankruptcy courts impose sanctions under Rule 9011 to deter parties from filing frivolous actions. *White v. Creditors Serv. Corp. (In re Creditors Serv. Corp.)*, 207 B.R. 567, 570 (Bankr. S.D. Ohio 1997). Thus, the bankruptcy court has broad discretion to determine whether sanctions are warranted. *Railroad Ctr. v. Thompson (In re Thompson)*, 165 B.R. 30, 32 (Bankr. M.D. Tenn. 1994). Nevertheless, in making its determination, the court "should avoid the wisdom of hindsight and objectively examine whether

the [party] made a reasonable pre-filing inquiry that factually and legally supported the filing of the pleading." *Creditors Serv. Corp.*, 207 B.R. at 570. Proofs of claim, as well as pleadings, fall under the umbrella of Rule 9011 sanctions. *Timmons v. Cassell (In re Cassell)*, 254 B.R. 687, 691 (B.A.P. 6th Cir. 2000).

Rule 9011 applies not only to attorneys but also to pro se litigants, who are held to the same duties under the Rule. See FED. R. BANKR. P. 9011(a); *McGahren v. First Citizens Bank & Trust Co. (In re Weiss)*, 111 F.3d 1157, 1170 (4th Cir. 1997) ("Rule 9011 does not exempt pro se litigants from its operation; a pro se litigant has the same duties under Rule 9011 as an attorney."); *Zussman v. Smilgoff (In re Zussman)*, 157 B.R. 404, 410 (Bankr. N.D. Ill. 1993) ("While pro se litigants are frequently given latitude in the review of their filings, Rule 9011 is applicable to them."). This is particularly true when, as in this case, the party's "pro se status has been respected at all stages of the proceedings," and the pro se party "is clearly intelligent and articulate." *Arleaux v. Arleaux (In re Arleaux)*, 229 B.R. 182, 186 (B.A.P. 8th 1999).

"[T]he test for imposing Rule 9011 sanctions is whether the individual's conduct was reasonable under the circumstances." *Mapother & Mapother, P.S.C. v. Cooper (In re Downs)*, 103 F.3d 472, 481 (6th Cir. 1996). Factors to be considered by the court "include the amount of time available for investigation, the nature of the investigation, and whether the claim is based on a plausible view of the law." *Cassell*, 254 B.R. at 691. In essence, sanctions are appropriate if (1) the document or claim is not well-founded and (2) it was filed for an improper purpose. *In re*

Primary Health Servs., Inc., 227 B.R. 479, 486 (Bankr. N.D. Ohio 1998). However, the court will not impose sanctions simply because a litigant was not successful in his litigation. *See Knowles Bldg. Co. v. Zinni (In re Zinni)*, 261 B.R. 196, 203 (B.A.P. 6th Cir. 2001). "Good faith omissions and mistakes or reliance on a reasonable but erroneous interpretation of the law will not usually be a basis for invoking Rule 9011." *In re Ligon*, 50 B.R. 127, 133 (Bankr. M.D. Tenn. 1985).

The first question before the court is whether there was evidentiary support for Mr. Justice's claim, or in other words, whether Mr. Justice held "a reasonable belief in the veracity of the [proof of claim]" on March 6, 2003, the date that he signed and filed it. *Primary Health Servs., Inc.*, 227 B.R. at 486. Additionally, the court must examine whether Mr. Justice filed his proof of claim with an improper purpose. "In determining whether a petition was filed for an improper purpose, the bankruptcy court must ask whether the [party's] conduct was reasonable under the circumstances." *In re Pannell*, 253 B.R. 216, 219 (S.D. Ohio 2000).

The court's decision as to whether to allow Mr. Justice's claim involved two complex issues under Tennessee law: (1) the proper parties to the consulting agreement forming the basis of the claim; and (2) novation. The first issue required the court to determine whether it should look beyond the corporation M.C.S.C., Inc., created by Mr. Justice within which to conduct his consulting business and find that Mr. Justice, individually, was the party with whom Mr. McCarter actually contracted. The second issue, novation, required the court to carefully examine

both the oral testimony of the parties and the twenty exhibits introduced into evidence to determine whether a new, separate contract with another party was substituted for the original consulting agreement contract, whereby Mr. McCarter's liability to Mr. Justice was actually extinguished. The complexity of this issue was such that the court requested supplemental briefs from the parties on whether a novation occurred.

The proof presented at trial evidenced Mr. Justice's reasonable belief that his claim was proper, and in fact, the court, on September 9, 2003, denied the Debtors' Motion for Summary Judgment filed on August 7, 2003, due to the existence of material issues of fact. Additionally, Mr. Justice prevailed on the first issue of the litigation; i.e., that he and not M.C.S.C., Inc., was the party with whom Mr. McCarter entered into the consulting agreement upon which Mr. Justice based his claim. Even though the court ultimately determined that the debt owed to Mr. Justice was no longer an obligation of Mr. McCarter due to a novation, the court reminds the Debtors that, at one time, Mr. McCarter did owe the obligation upon which Mr. Justice's proof of claim was based. The novation occurred as a legal consequence of several actions taken by Mr. Justice and others, all of which are discussed in the Memorandum on Debtors' Objection to Claim of Joe F. Justice, III, filed on November 25, 2003. The court does not question Mr. Justice's good faith in filing his proof of claim, nor does the court find that it was unreasonable or filed with an improper purpose. As such, the Debtors' Motion for Sanctions is without merit and shall be denied.[2]

[2] The court does not, however, find that the Debtors filed their Motion for Sanctions in bad faith, and nothing in this Memorandum should be construed in that context.

An order consistent with this Memorandum will be entered.

FILED: December 16, 2003

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

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Case No. 02-31000

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Debtors

O R D E R

For the reasons stated in the Memorandum on Debtors' Motion for Sanctions filed this date, the court directs that the Motion for Sanctions Under Rule 9011 of the Federal Rules of Bankruptcy Procedure filed by the Debtors on October 20, 2003, seeking the imposition of sanctions against Joe F. Justice, III, is DENIED. The March 1, 2004 trial date for hearing the Motion is accordingly STRICKEN.

SO ORDERED.

ENTER: December 16, 2003

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE